

***United States Court of Appeals
for the Second Circuit***



**BRIEF FOR
APPELLANT**

ORIGINAL
WITH PROOF
OF SERVICE

76-7476

UNITED STATES COURT OF APPEALS

for the

SECOND CIRCUIT

B

P/S

NEWBURGER, LOEB & CO., INC. as Assignee of Claims of David
Buckley and Mary Buckley,

Plaintiff-Appellant-Cross-Appellees,

-against-

CHARLES GROSS, MABEL BLEICH, GROSS & CO., and JEANNE
DONOGHUE,

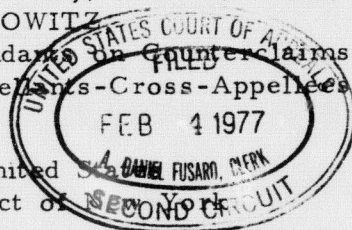
Defendants-Appellees-Cross-Appellants,

-and-

NEWBURGER, LOEB & CO., a New York Limited Partnership, ANDREW
M. NEWBURGER, ROBERT L. NEWBURGER, RICHARD D. STERN, as
Executors of the Estate of Leo Stern, ROBERT L. STERN, RICHARD D.
STERN, JOHN F. SETTEL, HAROLD J. RICHARDS, SANFORD ROGGEN-
BURG, HARRY B. FRANK and JEROME TARNOFF, as Executors of the
Estate of Ned D. Frank, FRED KAYNE, ROBERT MUH, PAUL RISHER,
CHARLES SLOANE, ROBERT S. PERSKY, FINLEY, KUMBLE, WAGNER,
HEINE, UNDERBERG & GRUTMAN, a Partnership, (formerly known as
Finley, Kumble, Underberg, Persky & Roth and Finley, Kumble, Heine,
Underberg & Grutman) and LAWRENCE J. BERKOWITZ

Additional Defendants on Counterclaims-
Appellants-Cross-Appellees.

Appeal from a Judgment of the United States District Court for the Southern District of New York



BRIEF OF ADDITIONAL DEFENDANT ON COUNTERCLAIMS-
APPELLANT-CROSS-APPELLEE FRED KAYNE

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Underberg & Grutman) and LAWRENCE J. BERKOWITZ,

Additional Defendants on Counterclaims-
Appellants-Cross-Appellees.

PRELIMINARY STATEMENT

This brief is submitted on behalf of Additional
Defendant on Counterclaim-Appellant-Cross-Appellee Fred Kayne

("Kayne"). Kayne appeals from a judgment against him and others entered by the United States District Court for the Southern District of New York (Owen, J.) in the amount of \$984,453.25, including \$258,623.60 in interest and \$50,000 in punitive damages. This judgment was rendered against Kayne in spite of the fact that the record was devoid of proof that he, or indeed any of the additional defendants on counterclaim, committed or participated in any tortious conduct.

STATEMENT OF THE CASE

A. Issues Presented For Review

1. Is there a legally cognizable claim for civil conspiracy where neither the acts allegedly constituting the conspiracy nor its purported objective is tortious?

2. Does a withdrawn general partner who, by written agreement, has left his capital at the risk of the partnership or a successor firm for twelve months after his withdrawal, have a claim for the immediate return of his capital because the assets of the partnership are transferred to a successor corporation?

3. Where a counterclaim is not compulsory and has no independent basis of federal jurisdiction, may the Court grant affirmative relief on the counterclaim by the device of amending the pleadings to conform to the proof?

4. May one who has not been sued in a federal court action voluntarily join as a defendant in that action in order to assert a counterclaim which has no independent basis of federal jurisdiction?

B. Proceedings Below

Plaintiff-Appellant-Cross-Appellee Newburger, Loeb & Co., Inc. (the "Corporation") commenced this action in February 1971 against Gross & Company and two of its partners, Charles Gross ("Gross") and Mabel Bleich ("Bleich"), who were also former partners of the Corporation's predecessor, Newburger Loeb & Co. (the "Partnership"). The complaint, relying on events between 1962 and 1966, sought \$300,000 damages for various securities laws violations arising out of and in connection with the churning of the account of Charles and Mary Buckley, customers of Gross & Company (2-9)*, which had cleared its customer accounts through the Partnership (E3-4). When the Partnership commenced arbitration to enforce its rights, the BUCKLEYS counterclaimed, alleging, inter alia, that Gross & Company had churned their account (E110-115). The Partnership

* The Joint Appendix is in three sections, the first, Volumes I and II, containing decisions, pleadings, affidavits, etc., is cited by the page number. The second section, Volumes I-VI contains the transcript and is cited as A The third is Exhibits, Volumes I-III and cited E

settled with the Buckleys by receiving a payment of \$50,000 and an assignment of the Buckleys' claim. The Partnership, as part of the transfer of assets to the Corporation, transferred to it the assignment of the Buckleys' claim.

The defendants and Jeanne Donoghue ("Donoghue"), who appeared sua sponte as a counterclaiming defendant, answered alleging nine counterclaims against the Corporation and additional defendants on counterclaims, all of which related to acts which had occurred in 1970 or 1971 (31-54). The additional defendants on the counterclaim were the Partnership, most of its former partners, two management consultants to the Partnership, a law firm which had represented the Partnership and one of the firm's former partners.

The first counterclaim alleged that the transfer of the assets of the Partnership to the Corporation was in violation of §98 of the New York Partnership Law and was ineffective because the transfer agreement was executed without the consent of all of the general and limited partners. It demanded that the transfer of the Partnership's assets to the Corporation be set aside, that damages be assessed, and that there be an accounting of profits.

The second counterclaim alleged that the assignment by the Buckleys of their claim to the Partnership was wrongfully induced by the Partnership in violation of its fiduciary duties to Gross, Bleich and Donoghue and resulted in a conversion

of their capital interests in the Partnership. It demanded an accounting of the capital interests of Gross, Bleich and Donoghue.

The third counterclaim sought \$200,000 damages for alleged conversion of warrants belonging to Gross.

The fourth counterclaim alleged the existence of a conspiracy to compel Gross, Bleich and Donoghue to consent to the transfer of the assets of the Partnership to the Corporation. It demanded damages in the amount of \$100,000 each for Bleich and Donoghue and \$500,000 for Gross, plus punitive damages in a like amount.

In the fifth, sixth and seventh counterclaims, Gross, Bleich and Donoghue demanded, pursuant to either the partnership agreement or the transfer agreement by which the Partnership's assets were transferred to the Corporation, the return of their capital plus interest.

In the eighth and ninth counterclaims Gross alleged that he had been prevented from obtaining employment as a securities trader at Rafkind & Company, Inc. and that this and the other actions set forth above constituted a violation of the Sherman and Clayton Acts.

In its answer and reply, the Corporation asserted counterclaims against Gross for money damages consisting mainly of allegations of malfeasance while he was the managing partner of the Partnership (55-74).

The District Court, by decision dated October 16, 1973 (365 F. Supp. 1364), on motions by all parties for summary judgment, ruled that the Court had jurisdiction of the first, second, fourth and ninth counterclaims, but that the others were available only as set-offs. The Court further found that the execution of the transfer agreement without the written consent of the limited partners was in violation of §98 of the New York Partnership Law, but ruled that rescission was unwarranted and that damages would be an adequate remedy (444-465).

A jury trial commenced on June 6, 1975, before Judge Richard Owen, and concluded seven weeks later on August 1, 1975. The jury was dismissed on July 18, pursuant to agreement among all parties.

On July 7, 1976, Judge Owen rendered an opinion and order which dismissed the Corporation's complaint; granted judgment to Gross on the first, second and fourth counterclaims against the Corporation, Kayne and all but two of the other additional defendants on counterclaims in the amount of \$337,921 on the ground that they had conspired to injure Gross in violation of their fiduciary duties to him. Although Judge Ward had previously held that the third counterclaim for conversion of Gross' warrants was not compulsory and was thus available only as a set-off, Judge Owen granted Gross affirmative relief on the claim in the amount of \$134,171.15 by a

purported "amendment" of the pleadings to conform to the proof. The Court also granted judgment to Donoghue and Bleich in the amount of \$76,868.75 each and awarded Gross \$50,000 in punitive damages. The total judgment, including interest, amounted to \$984,452.25. All other claims, including Gross' ninth counterclaim, were dismissed. (508-537).

C. Statement Of Facts

1. The Serious Financial Condition
Of The Partnership

On February 11, 1971, the Partnership, a member of the New York Stock Exchange ("Exchange"), was threatened by the Exchange with immediate suspension because of the Partnership's imminent insolvency (522-523). The Exchange had effectively notified the Partnership that unless additional capital was introduced by that date, it could not open for business the following day (E1-2).

This crisis had been developing for some time, during most of which Gross had been managing partner. As early as September 1969, the Exchange had imposed trading restrictions on the Partnership because its faulty record keeping had rendered it impossible to determine whether the Partnership was meeting the capital requirements of the Exchange's rules (E179-180). Although the Exchange removed the restrictions in January 1970, it pointed out that the record keeping problem

and an apparent lack of supervision had not been resolved (E 199, 193-194).

On March 24, 1970, the Exchange notified the Partnership that it was concerned over the Partnership's losses and weak capital position. The Exchange gave the Partnership until April 6, 1970, to report on its plans for introducing new capital and for stemming its losses (E203).

On July 23, 1970, the Exchange censured and fined the Partnership \$50,000 for record keeping violations and misstatements in the reports it was required to file (E213). By August 1970, the Partnership had lost \$1.3 million since the beginning of the calendar year (E 1065).

2. Kayne Is Induced To Join
The Partnership

One way in which the Partnership had attempted to alleviate some of its problems had been to attract successful registered representatives with established clientele into the Partnership. Kayne was one of those who was successfully lured into the Partnership's California office.

Kayne, a graduate of MIT's graduate engineering program in industrial management, had been a registered representative since 1966, first with the firm of Francis I. DuPont and then McDonnell & Co. and its successors, Shearson Hammill. At the time of trial he was the resident manager of the Bear Stearns & Co. Los Angeles office (A3404-3405). During these

years he had obtained numerous customers for these firms and had earned in excess of \$100,000 a year (A3412-3413).

In late 1969, he and Charles Sloane ("Sloane") were induced to join the Partnership on the basis of Gross' representation that the Partnership was profitable (A3501-3502). Nothing could have been further from the truth. In 1969 alone, the Partnership had lost over one million dollars (A3502). Moreover, Gross did not advise them of any of the back office problems the Partnership was then experiencing or of the severe trading restrictions imposed upon the Partnership by the Exchange (A3546).

Kayne was first employed by the Partnership as a registered representative (A3407). He became a partner at Gross' behest in late February 1970 when Gross offered to arrange a loan for his entire capital contribution of \$50,000 (A3501). Gross never followed through on this promise, and Kayne was forced to obtain financing for the entire sum (A3407).

Once Kayne was a partner, he became alarmed when Gross casually informed him after a party celebrating the opening of the Partnership's new California office that the Partnership had lost over \$200,000 in the month of March 1970 (A3408-3409). Based upon Kayne's percentage of interest in the Partnership, Kayne had thus lost \$4,000 in one month (A3409). In an attempt to obtain more information about the Partnership's losses, Kayne and Sloane attended three executive meetings in

New York City during May, June and July of 1970 (A3408). Upon obtaining an accurate financial picture of the Partnership, Kayne determined to resign in July 1970 (A3410).

The Partnership, which did not want to lose Kayne or his customers, sent two general partners, Robert Therese and Ned Frank, to California to change his mind. After an all-night session, they succeeded. They pointed out that there was no way he could leave the Partnership without facing financial disaster and permanent jeopardy, and, in fact, that his resignation would help to accelerate the demise of the Partnership (A3411-12, 3416).

At this meeting, Frank and Therese outlined what they felt were the most serious problems facing the Partnership, not the least of which was a lack of management or financial supervision. It was their belief that the Partnership was "basically incapable of moving forward" without the infusion of new management, and suggested that the present management would welcome "a new face" like Kayne's. Kayne thought it would be presumptuous of him to be involved in the running of the Partnership, but agreed to come to New York at a later date and discuss it with the other partners (A3414, 3416-3418).

Frank and Therese returned to New York, discussed their proposal with the other partners and arranged a meeting among Kayne, Gross and the other partners (A 3418). Although he had not made his intention known, Gross had already decided to resign

as managing partner because of the Partnership's lack of progress and continuing losses (A 3418-3420).

3. Gross Resigns as Managing Partner; Steps to Remedy the Partnership's Financial Problems

At the meeting, which was held in late July 1970 at the Hotel Navarro in New York, Gross was asked by the partners to step down as managing partner (A 3419). He agreed and resigned as of August 11, 1970 (A 3420, 3436). The partners then asked Kayne, and he agreed, to become assistant managing partner until Gross' resignation as managing partner became effective (A 3420-3421).

On becoming managing partner, Kayne attempted to deal with the problems which Gross had left in his wake (A 3422-3424). In August 1970, the Partnership retained Risher and Muh & Co., Inc. as management and financial consultants and the law firm of Finley, Kumble, Underberg, Persky & Roth to assist it in straightening out its affairs (A 3421-3422). Muh, Risher and Robert Persky, a member of the Finley Kumble firm, began to formulate plans to restore the Firm to financial health (A 3422, A 3433-3434; E 1064-1081). These plans included the sale of a losing investment of several hundred thousand dollars in the Buffalo Braves, a basketball team, negotiating the termination of leases on excess office space and solving the Partnership's capital problems (A 3431-3436; E 1066-1070).

Kayne concentrated his efforts on meeting with the key personnel of the Partnership and the Exchange and conducting intensive discussions with the thirteen banks that had loaned the Partnership \$15,000,000 (A 3425).

No sooner had Kayne met with the Exchange officials than they imposed upon the Partnership the first of what was to be a number of deadlines by which the Partnership was to increase its capital (A 3425-3426, 3436). Kayne immediately responded in a letter dated August 21, 1970, and described the Partnership's plans to resolve its capital problems (A 3435-3436; E 1053-1055).

Under Kayne's direction, the Partnership capital problems were substantially alleviated in late August 1970, by the negotiation of the largest clearing agreement on Wall Street, whereby the Partnership transferred its customer accounts and over \$100 million in securities to W. E. Hutton & Co. (A 3427-3428). Second, the Partnership effected the sale of its interest in the Buffalo Braves, which had cost it several hundred thousand dollars and was threatening to generate still further losses (A 2736-2738; E 1066). Third, the Partnership negotiated itself out of leases for excessive office space which had been made while Gross was managing partner (A 2746-2747; E 1067-69). While these measures alleviated the strain on the Partnership's capital, there remained the problem of attracting new capital sufficient to meet the requirements of the Exchange.

4. Gross Withdraws from the Partnership;
the Partnership Agreement

On August 31, 1970, Gross unexpectedly resigned as a general partner effective September 30, 1970 (A 4970; E 856-858). The Partnership agreement provided* that upon the withdrawal of a general partner, and the continuation of the Partnership or a successor firm, all of the withdrawing partner's cash, property and interests would be treated as capital contributed to the successor firm for a period of twelve months from the date of withdrawal (E 420-421). Thus, Gross could not withdraw his capital until September 30, 1971. Moreover, the agreement provided that the withdrawing partner's claim against the successor firm was subordinate to all debts arising during the twelve month period subsequent to the partner's withdrawal (E 443-444).

Kayne, in an attempt to persuade Gross to withdraw his resignation, met with him and his attorney, Golenbock. Gross not only refused to cooperate with Kayne's attempts to revitalize the Partnership but also stated he would prefer the Partnership to liquidate (A 3461-3462).

The general partners had a number of legitimate grievances against Gross. Prior to Gross' becoming a partner

* See p. 36 ; infra.

he had had his own brokerage business, which cleared its customers accounts through the Partnership. As noted above, the Buckleys, who were customers of Gross & Company defaulted on a \$332,345 debt to the Partnership arising from their trading (A 894-895; E 101). When, in 1970, the Partnership sought to enforce its claim against the Buckleys through arbitration they counterclaimed, alleging that Gross & Company had churned the account and had otherwise violated the securities laws (E 110-115). The Buckleys' setoffs and counterclaims amounted to about \$695,000 (E 110-115). In December 1970, the Partnership was forced because of its dire financial condition to settle its claim by the Buckleys paying less than one-tenth of their debt (A 905-908; E 129).

Moreover, it was after Gross became managing partner of the Partnership in 1969 that its record keeping and financial problems arose and it was fined \$50,000 by the Exchange (A 3749; E 213). In addition, Gross had been responsible for the losing investment in the Buffalo Braves, and had refused an offer of \$100,000 by the landlord of space which the Partnership had leased at 1 New York Plaza to relinquish the lease (A 1945-1948; E 152-153). Later, the Partnership had to pay the landlord about \$400,000 to get out of the lease (A 2747).

5. Kayne Continues His Efforts to Restore
the Partnership to Financial Health

Kayne spent most of September working on plans to cut costs and raise additional capital (A 3463-3464, 3469). As

a means of resolving the capital deficit, Kayne proposed the assignment by the partners of their tax refunds to the Partnership to cover their deficits. This met stiff resistance. Frustrated by his inability to resolve the capital problems, Kayne resigned from the Partnership at an executive meeting in early October 1970. He was later persuaded by Robert Newburger to withdraw his resignation and continue his efforts to resuscitate the Partnership (A 3473-3476).

6. Kayne Withdraws as a Partner

Despite these efforts, the Partnership continued to lose money during the months of September and October (A 3477-3478). Moreover, there had been no progress in obtaining tax assignments from the partners or in raising of additional capital (A 3479). Kayne, faced with these problems and a wife who was critically ill, resigned from the Partnership in November 1970, effective as of November 30 (A 3479-3480).

After a brief vacation with his wife in the Carribean, Kayne returned to California, where he continued to act as a registered representative for the Partnership (A 3481-3482). In August 1970, it had been agreed that certain warrants which had been previously acquired by the Partnership with its own funds were to be attributed to the accounts of the individual partners, including Gross (E 848). Subsequently, one of the partners, who was a practicing attorney, advised Kayne that these warrants

were actually property of the Partnership (A 3489). In view of this, and the Partnership's suffering continuous losses throughout 1970, Kayne suggested that the warrants be retained by the Partnership until a balance could be struck reflecting the amount in each partner's capital account (A 3489-3490, 3493). Nothing was done as a result of Kayne's letter and no change was made on the books of the Partnership (A 2969, 2974, 3493-3494).

During the first week of January 1971, Kayne and Sloane also sought legal advice concerning their grievances against Gross for inducing them into the Partnership with false and misleading financial information. They met several times with one of the senior partners of a major firm in California, who suggested that they could bring suit in federal court in California for purchasing a security (their partnership interests) across state lines on the basis of fraudulent misrepresentations (A 3495-3506). The law firm nevertheless suggested that Kayne try to resolve his differences with Gross because of the high cost of bringing such a lawsuit (A 3509).

7. Risher, Muh and Persky Plan to Revive the Partnership

With Kayne out of the picture, Risher and Robert Newburger, a general partner, took over attempts to salvage the Partnership (A 2753-2756). On November 16, 1970, four general partners of the Partnership met with representatives of the Department of Member Firms of the Exchange. At the meeting

it was noted that in view of the deficiencies in the capital accounts of partners and expected capital withdrawals, the Partnership would be in violation of the net capital rules of the Exchange by November 30, 1970 (E 1). The Exchange, in a letter the following day, advised the Partnership that unless it met the "excess capital" rule of the Exchange by November 20, 1970, the Department of Member Firms would recommend to the Board of Governors that the Partnership be suspended and liquidated (E 1-2).

On November 18, 1970, Risher, Muh and Newburger met with the limited partners, and explained the serious financial condition of the Partnership. Risher requested that the limited partners refrain from withdrawing their capital from the Partnership; otherwise it would go out of business (A 2755-2756). On the basis of the negotiations with the limited partners and others, the Partnership requested and received from the Exchange an extension of its proposed suspension and liquidation to December 18, 1970 (E 221-224).

There followed further negotiations among the limited partners, general partners and subordinated lenders to arrive at an acceptable plan to salvage the Partnership. In late November or early December a plan of reorganization was proposed by Risher and Muh (A 2760-2761). The general partners at first rejected the plan and discharged Risher and Muh (A 2761). At a subsequent meeting attended by the general partners, Risher,

Muh, Persky, the limited partners, and their counsel, Risher and Muh were requested by the limited partners to prepare a revised plan (A 2764-2767, 2769-2770).

Kayne, who was out of the country, took no part in the negotiations or in the formation of the plan and was not informed of either (A 3480-3482).

Thereafter, the plan was revised to take into account the objections voiced by the limited partners and the request of the Exchange that Kayne be included in the reorganization (A 2875, 3484). On December 17, 1970, Robert Newburger sent the plan, as revised, to the Exchange (E 221-228). The essential elements of the plan were as follows:

1. The Partnership would be converted to a corporation;
2. Limited partners would receive convertible debentures equal to the amount of their accounts;
3. General partners would make up \$900,000 of a \$1,300,000 capital deficiency, principally through expected tax refunds, and general partners with positive capital positions would receive an equivalent amount of preferred stock;
4. Subordinated lenders would be requested to extend their loans for three years;
5. Approximately \$1,000,000 in stock would be made available to the corporation as a senior subordinated loan repayable in three years, the lender, Alex Aixala to receive 5% interest on his loan and 20% of the common stock of the new

corporation;

6. Risher, Muh and Kayne would become, respectively, chairman, president and executive vice president of the new corporation. Each would also become a director and purchase 200,000 shares of common stock for \$10,000 (E 222-228).

After a further extension from the Exchange, the parties, on December 30, 1970, agreed to the proposed plan, with minor changes, and an agreement was drafted dated as of December 31, 1970, transferring the assets of the Partnership as successor corporation. On January 7, 1971, the Exchange wrote to the Partnership and said it would need additional documentation by January 8, 1971 -- an obviously impossible deadline -- for the Board of Governors of the Exchange to consider the plan at its next meeting scheduled for January 28, 1971. The earliest subsequent date at which the Board could consider the plan was February 11, 1971 (E 229).

On January 11, 1971, the Exchange notified the Partnership that it would not approve the plan in its present form because on the basis of its pro forma financial statement, the successor corporation would be in violation of the net capital rules of the Exchange from inception; Risher and Muh had no prior broker-dealer experience; and the closing date of January 25, 1971, proposed in the plan would fall prior to the next meeting of the Board of Governors, which would thus not have time to give its approval to the successor corporation prior to its formation (A 2775-2778; E 229). The Exchange

advised the Partnership to proceed with an orderly liquidation to be completed by January 25, 1971 (E 229).

The Exchange, however, took no immediate action, and the Partnership then attempted to overcome the objections and prepare for a closing by the date of the next meeting of the Board of Governors on February 11, 1971. In this connection, the Partnership sought to resolve questions of certain encumbrances on part of the stock which Aixala was to lend the successor corporation and explained to the Exchange that Kayne, who would be executive vice president of the new corporation, had experience as a broker-dealer and had been a member of the Partnership and that this would outweigh any lack of experience on the part of Risher and Muh (A 1218-1219, 2775-2778).

8. Gross Schemes to Frustrate the
Reorganization and Force Liquidation

At about this time, Gross began to effectuate a scheme to frustrate the reorganization. During the time he was a partner, Gross had favorably considered the reorganization of the Partnership into a corporation (A 3444). Once he had resigned, however, he changed his position (A 3462). Although he had no legal standing to do so, he began to raise objections to the plan and push for immediate liquidation (A 1252-1254, A 2343, 3462; E 704). His purpose was to obtain the immediate return of his capital and thereby avoid his obligations under the partnership agreement.

Gross, who had withdrawn as a partner and was required to leave his capital at risk in the Partnership or a successor firm for one year, had no right, either under the partnership agreement or under §98 of the Partnership Law, to block the reorganization. Two limited partners, however, were close to Gross: Bleich, who was his former secretary and partner in Gross & Company, and Donoghue, who was his sister and also his former partner (A 1174, 1752, 4290). Gross, therefore, sought to frustrate the reorganization by taking advantage of his relationship with Bleich and Donoghue (A 2473-2474).

Bleich and Donoghue withdrew from the Partnership on December 30, 1970 (E 691, 692). On January 14, 1971, Gross called Arthur Silverman of the firm of Golenbock & Barell, who were the attorneys for Donoghue and Bleich, and told Silverman that Donoghue would not consent to the reorganization (E 233, 698). Silverman called Donoghue to verify that she had rejected the plan and, because he thought the plan was in her best interest, tried to persuade her to change her mind, but was unsuccessful (E 235-236, 698).

Shortly thereafter, Persky and others held meetings with Gross' attorney, Mandel, in an attempt to accommodate Gross and obtain the consent of Bleich and Donoghue (E 699). Kayne was not at the meetings and had no prior knowledge that they were taking place (A 5014-5016, 5048-5049). No accommodation was reached and Gross' attorney made it clear that Gross

would take whatever steps were available to block the transfer, saying, at one point, "Charles doesn't have to do a thing. Jeanne is not going to change her mind. Blood is thicker than water." (E 707).

Following the advice of his California attorneys, Kayne met with Gross in New York on January 23, 1971, to attempt to reconcile their differences. Gross insisted that he was entitled to the immediate return of his capital. Kayne informed Gross that Gross had induced him to join the Partnership on the basis of misleading financial information and that he held Gross responsible for this (A 3510-3516). Upon Kayne's return to California, Kayne and Sloane, both of whom had lost their entire investments in the Partnership, told their law firm that the meeting with Gross was futile and to commence an action against Gross for fraudulently inducing them to become partners in the Partnership (A 3517). The suit was filed on February 3, 1971 (A 3524-3525).

Originally, Bleich, a limited partner, had given her consent to the transfer (E 233). Gross, however, was still insisting that the Partnership be dissolved and on February 1, 1971, Bleich withdrew her consent (E 726). She did this in the face of contrary advice from her attorneys (A 1679, 4388-4389; E 233, 695) and after several discussions with Gross (A 4417-4418).

On February 5, 1971, Silverman and Mandel met with Persky and the attorneys for the general and limited partners and subordinated lenders (A 1738-1739; E 730-738). Kayne was not present. The partners and lenders were objecting to Gross' demands for the immediate return of his capital, whereas they were willing to forego the return of their investment. At the meeting a formula was evolved whereby Gross would receive back some of his capital and leave the balance with the Partnership (A 1173-1174, 1938; E 730-738). Although Mandel recommended the settlement to Gross, Gross rejected it (A 1173).

On February 8, 1971, Persky and Muh again met with Silverman, Gross and Mandel (A 1754-1755). The Exchange had threatened to suspend the Partnership unless the reorganization was consummated on February 11, 1970 (A 1944-1945). As before, no accommodation was reached with Gross (A 1756-1757).

9. The Transfer of the Assets
to the Corporation

On February 11, 1971, a meeting was held to effect the transfer of the Partnership's assets and liabilities to the successor corporation. About 35 people were present, including Risher, Muh, Kayne, general partners, limited partners and subordinated lenders and their attorneys (A 5049). Prior to the meeting, all of the interested parties except Bleich and Donoghue (who were not present) had agreed in principle to the transfer. These parties were represented by prominent

counsel, including Rosenman, Colin, Kaye, Petschek, Freund & Emil (the Partnership), Willkie, Farr & Gallagher (the subordinated lenders), Stroock & Stroock & Lavan, and Richenthal, Abrams & Moss (the limited partners). During the course of the meeting, which lasted many hours, the various interested groups reviewed and discussed the proposed agreement and numerous changes were made (A 1124).

One of the issues which had to be faced at the closing was the question whether, under §98(1)(b) of the New York Partnership Law, the transfer of the Partnership's assets to the successor corporation could be accomplished without the consent of Bleich and Donoghue (A 1126, 1128). Although the Rosenman firm, which was special counsel to the Partnership in the reorganization as well as counsel to one of the general partners, believed that the transfer was in the best interests of their clients, it could not give an opinion that the transfer could be made unless Bleich and Donoghue agreed (A 2128, 2185-2186). Persky, whose firm was acting as counsel to the successor corporation, stated that he had researched the question and that in his opinion the transfer would be proper (A 1126-1127). With the consent of all of the parties present, Persky, as special counsel to the Partnership prepared an opinion letter stating that notwithstanding the provisions of §98(1)(b) of the Partnership Law, the Partnership had the power and authority to enter into the transfer agreement and to consummate the

transactions thereunder (E 135-136). In reliance upon this legal opinion, all of the parties present agreed to the transfer and the reorganization was accomplished (A 1127). On the following day, the Corporation commenced business with the approval of the Exchange.

On February 16, 1971, the Corporation, as successor to the Partnership and assignee of the Buckleys' churning claim, commenced this action against Gross, Gross & Company and Bleich (1-9).

SUMMARY OF ARGUMENT

Conspiracy is not, of itself, a civil wrong and does not constitute a tort. In order for a civil conspiracy to be legally cognizable, the parties thereto must have committed a separate tort. Neither the actions taken pursuant to the alleged conspiracy nor its purported objective of compelling Gross to agree to the transfer constituted a tort.

Gross, as a withdrawn partner, was required under the terms of the partnership agreement to leave his capital at the risk of the Partnership or any successor firm for twelve months from the date of his withdrawal. Hence, as a withdrawn general partner, he had no standing to object to the transfer. His rights were defined solely by the agreement and not by §98 of the Partnership Law. Thus, even assuming that the transfer was in violation of §98 because Bleich and Donoghue had not

consented, the transfer did not violate Gross' rights and there could not be a civil conspiracy to deprive him of those rights.

Gross' counterclaim for conversion was not a compulsory counterclaim and had no separate basis of federal jurisdiction. The counterclaim was held by Judge Ward to be available only as a set-off against the Corporation's claims. The granting of affirmative relief on the counterclaim against Kayne under the guise of a motion to amend the pleadings to conform to the proof at trial was an unwarranted and improper extension of the Court's jurisdiction.

Finally, Donoghue was not named by the Corporation as a defendant and simply joined, sua sponte, in the defendants' answer as a counterclaimant to assert a claim which had no basis of federal jurisdiction. No amended complaint naming her a defendant was ever served or filed. Hence, the District Court lacked jurisdiction to award judgment on her counterclaim.

POINT I

NONE OF KAYNE'S ACTIONS CONSTITUTED
LEGALLY COGNIZABLE WRONGS

The principal ground upon which the District Court based its judgment in favor of Gross was a finding of a civil conspiracy to compel Gross to consent to the transfer of the Partnership's assets to the Corporation (521, 526-527). By finding conspiracy, the Court attempted to involve Kayne with every action taken by every other defendant on counterclaim, even though Kayne was out of the country or in California during the life of the "conspiracy". The only direct contacts between Kayne and Gross during this period were two: a half-hour luncheon meeting in New York in January 1971 and the commencement of Kayne's federal action against Gross for fraudulent inducement of Kayne to become a member of the Partnership. As will be shown below, neither of those acts were tortious. Hence, the key to the judgment against Kayne -- and the other defendants on counterclaims -- was the finding of a conspiracy.

It is well established that conspiracy alone is not a civil wrong. Essential to a cause of action for conspiracy is the commission of some wrong which would give rise to a claim independent of any conspiracy. As stated in Cuker Industries, Inc. v. William L. Crow Const. Co., 6 A.D.2d 415, 178 N.Y.S.2d 777, 779 (1st Dep't 1958):

"The allegation of a civil conspiracy, without more, does not in and of itself give rise to a cause of action. The actionable

wrong lies in the commission of a tortious act, or a legal one by wrongful means, but never upon the agreement to commit the proposed act standing alone."

See also, Goldstein v. Siegel, 19 A.D.2d 489, 244 N.Y.S.2d 378, 382 (1st Dep't 1963). ("There is no substantive tort of conspiracy."); Health Delivery Systems, Inc. v. Schienman, 42 A.D. 567, 344 N.Y.S.2d 190, 192 (2d Dep't 1973); Meyerson v. Lawyers Title Insurance Corp., 39 A.D.2d 190, 333 N.Y.S.2d 33, 37 (1st Dep't 1972).

A lawful act does not become unlawful because two or more people combine to do it. A conspiracy is actionable only if the conspirators commit a tortious act which results in injury. If the act done is not otherwise tortious, then an agreement to do it is not actionable even though injury may have been caused.

A case precisely in point is Dalury v. Rezinas, 183 App.Div. 456, 170 N.Y.Supp. 1045 (1st Dep't 1918). In that case, plaintiff and one of the defendants, Rezinas, formed a partnership, Rezinas contributing a hotel business and a lease of the premises. They disagreed and plaintiff commenced an action for dissolution and for an accounting. Their rent was in arrears and the lessor evicted Rezinas from the hotel premises and relet it to two dummies named by Rezinas. The receiver in the dissolution proceedings also auctioned the hotel furnishings to the same dummies. Plaintiff claimed that

all of the foregoing actions constituted a conspiracy to deprive him of his participation in the partnership. The court affirmed a judgment for defendants, stating:

"It is a well-settled rule of law that no action lies where a person has been damaged by another through the doing of a lawful act, or in the enforcement of a legal remedy, no matter if the purpose and intent of the act was malicious. It is the act done that must be considered, and not the intent with which it was done."

* * *

"Nor does a lawful act become unlawful because two or more combine to do the act. A conspiracy is an agreement between two or more persons to do an unlawful act. If the act to be done be not unlawful, then the agreement or combination to do it is not a conspiracy, and injury caused thereby is not actionable, except a combination which assumes a public or quasi public aspect." 170 N.Y.Supp. at 1048-1049.

See also, Routsis v. Swanson, 26 A.D.2d 67, 270 N.Y.S.2d 908 (1st Dep't 1966), and cases there cited.

In the instant case, the partners, both limited and general, other than Gross, Bleich and Donoghue, and the subordinated lenders, all believed that the only way to save the business - - and hence their investments - - was to reorganize the Partnership into a corporation. Gross, the lone general partner holdout, wanted the Partnership dissolved. But Gross, a general partner who had already formally withdrawn from the Partnership, had no right to block the reorganization. He was required to leave his capital at the risk of the Partnership or its successor firm for twelve months after his withdrawal.

Nonetheless, he stubbornly attempted to frustrate the transfer of the Partnership's assets to the Corporation in the hope of forcing a dissolution and circumventing his agreement. He did this by causing Donoghue and Bleich to object to the transfer. Such was his influence that both of them objected to the transfer in the face of contrary advice from their attorneys (A 1679, 4388-4389; E 235-236, 698).

Gross knew precisely what he was doing -- his attorney said, with reference to the relationship between Gross and Donoghue, "Charlie doesn't have to do anything. Jeanne will never change her mind. Blood is thicker than water." (E 707). Gross believed that by persisting in his objection to the transfer he could bring the remaining partners and subordinated lenders to their knees. He would then bootstrap himself into the immediate return of his capital which, under the partnership agreement, was to remain at the risk of the Partnership or its successor for twelve months. In short, Gross was withholding Bleich's and Donoghue's consents to the transfer in order to ransom his own capital.

Even assuming that Gross was within his legal rights in seeking to force the Partnership to return his capital in this way, there is no reason, in law or in justice, why the remaining partners had to refrain from enforcing any rights which they believed that they had against Gross. Kayne

had lost all but \$1,000 of his original investment of \$50,000 before he withdrew from the Partnership and many of the partners who remained faced the total loss of their capital unless the business could be saved. Moreover, Kayne and many of the partners had reason to blame Gross for the predicament in which they found themselves. The capital losses, the censures and fines by the Exchange and the losing investments all occurred while Gross was managing partner and Kayne believed that Gross had fraudulently induced him to joint the Partnership. The District Court, however, imposed a "double standard" upon Kayne and the other defendants on counterclaims in favor of Gross. While Gross could attempt to blackmail the Partnership into returning his capital in contravention of his express agreement by influencing Bleich and Donoghue to withhold their consent to the transfer, the assertion by the other partners of their claims against Gross constituted an illegal conspiracy to injure him.

There is no basis in law for such a double standard. Merely stating that one will assert legal claims against another is not tortious. Avery v. Town of Brant, 263 N.Y. 320, 189 N.E. 233 (1934); Stayton Realty Corp. v. Rhodes, 200 App.Div. 108, 192 N.Y.Supp. 683 (1st Dep't), aff'd, 234 N.Y. 515 (1922); Steward v. World-Wide Automobile Corp., 20 Misc.2d 188, 189 N.Y.S.2d 540 (Sup. Ct. Queens Co. 1959); 17 N.Y. Jur., Duress and Undue Influence §21. Neither is the actual assertion of

such claims tortious, even if they fail, in the absence of some extraordinary interference in the person or property of the defendant. Williams v. Williams, 23 N.Y.2d 592, 298 N.Y.S.2d 473, 476-77 (1969); Metromedia, Inc. v. Mandel, 21 A.D.2d 219, 249 N.Y.S.2d 804 (1st Dep't), aff'd, 15 N.Y.2d 616, 255 N.Y.S.2d 660 (1964); Chappelle v. Gross, 26 A.D.2d 340, 341, 274 N.Y.S.2d 555 (1st Dep't 1966); Burt v. Smith, 181 N.Y. 1, 73 N.E. 495 (1905); 36 N.Y.Jur. Malicious Prosecution §10.

Even were the law less clear on this point, the facts utterly fail to support a conclusion that Kayne brought his action maliciously or for the purpose of compelling Gross to consent to the reorganization. The mere fact that Kayne continued to prosecute his claim after the original suit was dismissed in California, well after the transfer and the formation of the Corporation, belies the District Court's conclusion that his objective was to obtain Gross' consent (A 3527-3528). After the suit was dismissed in the fall of 1971, Kayne obtained New York attorneys to proceed with arbitration before the Exchange (A 3527-3529). The arbitration continued for 24 sessions, spanning a period of some two to three years (A 3529-3530). Either Kayne or Sloane was present at each session (A 3530). The total fees and expenses for the arbitration amounted to \$28,000, which were paid by Kayne and Sloane personally (A 3532-3533; E 1045-1047). By the time Kayne's litigation with Gross was resolved, the reorganization had long been consummated

(A 3529) and Gross' consent would have made no difference even if legally required, which it was not.

Accepting, arguendo, Gross' version of their luncheon meeting, Kayne's offer to Gross not to press his claim if Gross consented to the transfer (A 2347) was entirely proper. At the time the proposal was made, Gross was attempting to thwart the reorganization. Originally, Kayne was not to take part in the reorganization proposed by Risher, Muh and Persky. He was added to the management of the successor corporation at the insistence of the Exchange (A 1613-1614). Having agreed to participate, Kayne hoped that an arrangement could be reached without litigation, which appeared inevitable when he met with Gross. Under the circumstances, Kayne was clearly within his rights in pointing out to Gross that if Gross persisted in his position, Kayne would persist in his. As a matter of law, there can be no coercion unless the purported victim has changed his position as a result of threats (extortion, etc.) made to him. See ATI, Inc. v. Ruder & Finn, Inc. (Sup. Ct. N.Y.Co., filed July 20, 1976), aff'd, No. 3730-1 (App.Div. 1st Dep't Dec. 16, 1976). Cf., Pearson v. Pearson, 29 Misc.2d 677, 212 N.Y.S.2d 281 (Sup. Ct. Kings Co. 1961); Steward v. World-Wide Automobile Corp., 20 Misc.2d at 196-97, 189 N.Y.S.2d at 549-50; Ippisch v. Moricz-Smith, 1 Misc.2d 120, 144 N.Y.S.2d 505 (Sup. Ct. Kings Co. 1955), modified on other grounds, 1 App.Div.2d 968, 150 N.Y.S.2d 419 (2nd Dep't 1956).

Here, Gross never withdrew his opposition to the reorganization and never changed his position.

Finally, even if Kayne and the other defendants on counterclaims had as their express objective the obtaining of Gross' consent to the transfer, this did not constitute an unlawful "conspiracy." Gross had no legal right to object to the transfer. Hence, no legal right of Gross was or could be infringed by the transfer - - he was merely holding hostage the consents of Donoghue and Bleich, who had originally consented (E 233), in an attempt to obtain a preference to which he was not entitled under the partnership agreement. The refusal to accord him such a preference was not tortious - - indeed, to have done so might have infringed the rights of other general and limited partners and subordinated lenders.

POINT II

THE TRANSFER DID NOT VIOLATE
GROSS' RIGHTS OR GIVE HIM A
CLAIM FOR THE RETURN OF HIS
CAPITAL

The second major ground upon which the District Court relied in awarding Gross damages for his asserted loss of capital was that the transfer of the Partnership's assets to the Corporation without the consent of Bleich and Donoghue constituted a violation of §98 of the New York Partnership Law (514). It is clear, however, that even if the transfer was in violation of §98, the transfer did not infringe any legal rights belonging to Gross and did not give him a claim for the return of his capital.

Section 98(1)(b) of the Partnership Law provides:

"(1) A general partner shall have all the rights and powers and be subject to all the restrictions and liabilities of a partner in a partnership without limited partners, except that without the written consent or ratification of the specific act by all the limited partners, a general partner or all of the general partners have no authority to"

* * *

"(b) Do any act which would make it impossible to carry on the ordinary business of the partnership."

As of September 30, 1970, Gross had withdrawn as a general partner of the Partnership (A 4970; E 856-858). As of November 30, 1970, Kayne had also withdrawn (A 3479-3480).

The partnership agreement provided in pertinent part with respect to withdrawing partners:

"3.5 . . . The parties hereto further agree that in the event any such partner ceases to be a partner, . . . and the continuation of the partnership by the remaining or surviving partners, with or without other partners or the formation by the remaining or surviving partners of a successor partnership or firm hold such securities, cash, other property or interests therein for the former partner, or for his estate, all such securities, cash, other property or interests therein held at the time such former partner ceased to be a partner shall continue to be treated as partnership property and shall be treated for all purposes as capital contributed by such former partner to the continuing or successor partnership or firm for a period of twelve (12) months after the date on which such former partner ceased to be such, during which time, subject to the provisions of paragraph 8.3 below, no withdrawal of any such securities, cash or other property may be made by such former partner or his heirs or personal representatives " (E 420-421).

* * *

"7.1(a) Any General Partner may withdraw from the partnership upon not less than thirty (30) days written notice to the partnership and to the New York Stock Exchange. Upon the effective date set forth in such notice, the partner giving notice shall cease to be a partner for all purposes and shall be paid out as provided in Article VIII below " (E 437).

* * *

"8.3 The partnership interest of a former General Partner who has withdrawn pursuant to paragraph 7.1 . . . shall remain in the successor firm and at the risk of the business for a period of twelve (12) calendar months from the effective date " (E 443).

At the time of the transfer of the Partnership's assets to the Corporation, neither Gross nor Kayne was a partner and both were required to leave their capital at the risk of the Partnership or a successor firm. Nothing in either the partnership agreement §98 gave Gross or Kayne the right to object to the transfer under those circumstances. Indeed, Gross conceded this at the trial (A 2525). Moreover, the transfer did not violate Gross' rights merely because it was made without the consent of Bleich and Donoghue. This can be clearly demonstrated by a brief review of the pertinent portions of the Partnership Law.

The Uniform Limited Partnership Act constitutes Article 8 of the New York Partnership Law. Article 8 deals almost exclusively with rights of limited partners. For example, limited partners are not bound by the obligations of the partnership or liable to its creditors except under certain circumstances, §§90, 96; limited partners have a right to inspect books and to receive a share of profits, §99; limited partners are only liable to the partnership for the amount of their agreed contribution, §106; and limited partners receive compensation and return of capital ahead of general partners, §112.

Nothing in Article 8, however, gives any rights to general partners. The substantive rights of general partners are set forth in the earlier sections of the Law, contained

in Articles 1 through 7. Even §98, which is entitled "Rights, powers and liabilities of a general partner" limits rather than expands, those rights vis-a-vis the limited partners.

On the other hand, the Partnership Law repeatedly recognizes that as among general partners, the partnership agreement can supercede the Law, even those provisions dealing with the rights of general partners. See, e.g., §§40, 41 44(2), 71. Thus, Gross' rights were defined by the partnership agreement, not by §98. Under that agreement, Gross' capital was to be left at the risk of the Partnership or its successor until September 30, 1971. Hence, he had no claim for the return of his capital even if the transfer to the successor firm was made over the objections of limited partners with standing to object under §98.

This conclusion accords not only with the clear pattern of the Partnership Law, but also with well established case law and common sense. One basic element of any civil wrong is that it cause damage. See Simon v. Noma Electric Corp., 293 N.Y. 171, 177, 56 N.E.2d 537, 539 (1944); Campbell v. Gates, 236 N.Y. 457, 460, 141 N.E. 914, 915 (1923); Penn-Ohio Steel Corp. v. Allis-Chalmers Mfg. Co., 7 A.D.2d 441, 184 N.Y.S.2d 58, 60 (1st Dep't 1959); Dalury v. Rezinias, supra, 170 N.Y. Supp. at 1049, 59 N.Y. Jur. Torts §10. Any damage suffered by Gross as a result of the transfer would be caused not by the failure of Bleich and Donoghue to consent to it any

more than such damage would be alleviated by their consenting. Whether Bleich and Donoghue consented or not, Gross would be in precisely the same position -- his damage, if any, would be the result of the provisions of the partnership agreement requiring him to leave his capital at risk with the Partnership.

It is well established that the breach of a duty owed to one party does not create a cause of action in favor of another party to whom no duty is owed, even if the latter is damaged. Williams v. State of New York, 308 N.Y. 548, 557, 127 N.E.2d 545, 550 (1955); Weicker v. Weicker, 28 A.D.2d 138, 283 N.Y.S.2d 385 (1st Dep't 1967), aff'd, 22 N.Y.2d 8, 290 N.Y.S.2d 732 (1968); 59 N.Y. Jur. Torts §7. Assuming that the transfer without their consent breached a duty owed under §98 to Bleich and Donoghue, this would not give rise to a cause of action in favor of Gross. Being a withdrawn general partner, Gross had no rights under §98. In order to assert rights accorded by statute, one must be within the class that the statute is designed to protect. Pauley v. Steam Gauge & Lantern Co., 131 N.Y. 90, 29 N.E. 999 (1892); Willy v. Mulledy, 78 N.Y. 310 (1879); 56 N.Y. Jur. Statutes §273.

This is the only practicable rule which can be applied to a case of this nature. The rights of general partners in a limited partnership who have bound themselves to an express agreement cannot be made to depend upon the fortuitous ability of one or another general partner to win a limited

partner over to his point of view. This would effectively destroy the partnership agreement which the general partners voluntarily entered. It would also permit a single partner with influence over a limited partner to impose his will on the other partners, general and limited, in spite of their economic interests and legal rights. This, in fact, is what happened here. The District Court believed that in awarding Gross damages because the transfer was illegal as to Donoghue and Bleich, it was protecting the rights of the minority. The Court was doing no such thing. It was enabling a single withdrawn general partner to avoid his obligations under the partnership agreement and to force the other partners and subordinated lenders to accede to his wishes in the face of the partnership agreement.

POINT III

THE LOWER COURT DID NOT HAVE JURISDICTION TO AWARD RELIEF ON GROSS' CLAIM FOR CONVERSION

Gross' third counterclaim alleged the conversion of certain warrants which were to be distributed to him and other general partners as an "in-kind" distribution of Partnership profits in August 1970 (44-45). The claim was based purely on common law - - it had no separate basis of federal jurisdiction. Judge Ward held, 365 F.Supp. at 1367, that the claim was not ancillary to the churning claim and hence was not compulsory and available only as a set-off. Judge Owen, however, after dismissing all of the Corporation's claims against Gross and saying that he would not consider the set-offs (514), granted Gross affirmative relief in the amount of \$134,171.75 against Kayne and certain other defendants on this counterclaim (536). He did this by saying that since the matter was litigated at trial, he was amending the pleadings to conform to the proof (536). The jurisdiction of the federal courts cannot be artificially expanded in this fashion.

The rules with respect to the assertion of counterclaims in federal actions are well defined. Rule 13(a) FRCP provides that a defendant must assert any counterclaim arising out of the same transaction or occurrence that is the subject matter of the plaintiff's claim. Such counterclaims do not require any separate basis of federal subject matter jurisdiction.

tion, such as a federal question or diversity of citizenship, but may be decided by the court as "ancillary" to the plaintiff's claim. 6 Wright & Miller, Fed. Prac. & Proc., §1414 (1971).

Rule 13(b) provides that a pleading may state as a counterclaim any claim against an opposing party not arising out of the transaction or occurrence that is the subject matter of the plaintiff's claim. For the court to adjudicate such a permissive counterclaim, however, it must have a separate basis of federal jurisdiction. It is not "ancillary" to the plaintiff's claim and hence not justiceable merely because the plaintiff shows a basis of federal jurisdiction to support his claim. Some courts have permitted permissive counterclaims to be used defensively, as a set-off, as Judge Ward did in the instant case. This, however, stretches federal jurisdiction as far as it will go. Wright & Miller, op. cit., §1422.

Gross' counterclaim for conversion did not arise out of the subject matter of the Corporation's churning claim against him. The alleged churning occurred from 1962 to 1966, before Gross was even a partner in the Partnership (4-9). The Corporation's allegations bore no relation to any contention that Gross did not receive a share in Partnership profits for the year 1970, which was the basis of Gross' counterclaim (44-45). Hence, the counterclaim, as Judge Ward held, was not

compulsory under Rule 13(a) but permissive under Rule 13(b). See, e.g., Tasner v. Billera, 379 F.Supp. 809, 813 (N.D. Ill. 1974) ["The compulsory counterclaim must be logically related to the original claim"]; West Coast Tanneries Ltd. v. Anglo-American Hides Co., 20 F.R.D. 166 (S.D.N.Y. 1957); Robinson Bros. & Co. v. Tygert Steel Products Co., 9 F.R.D. 468 (W.D. Pa. 1949) [Court did not even allow permissive counterclaim to be pleaded as set-off].

Moreover, the counterclaim had no independent basis of federal jurisdiction. There was no diversity of citizenship between the Corporation and Gross and the counterclaim alleged no jurisdictional basis under federal law - - as, indeed, it could not (44-45). Thus, Judge Ward granted Gross every benefit available to him under such circumstances by allowing the counterclaim to stand as a set-off (448-449).

In view of this, Judge Owen's granting affirmative relief on the counterclaim merely because the issue had been litigated and because he had the power under Rule 15(b) to amend the pleadings to conform to the proof (536) was clearly erroneous. Since the claim was allowed to stand as a set-off, it had to be litigated, because at the time of trial none of the parties knew what the eventual decision would be on the churning claim. If the lower court had sustained that claim, it would have had to consider the counterclaim to determine

whether Gross had proven his set-off and was entitled to defeat the churning claim on that ground. But once the Court determined that the churning claim had failed on the merits, the set-off was no longer a part of the case.

Rule 15(b) did not entitle the District Court to grant affirmative relief on the counterclaim merely because it had been litigated. Rule 82 expressly provides that the Federal Rules of Procedure shall not be construed to extend the jurisdiction of the federal courts. See, Dery v. Wyer, 265 F.2d 804, 808 (2nd Cir. 1958); Audi Vision, Inc. v. RCA Mfg. Co., 136 F.2d 621, 624 (2nd Cir. 1943); 12 Wright & Miller, Fed. Prac. & Proc., §3141 (1971). By using Rule 15(b) as he did, Judge Owen effectively overruled Judge Ward's correct decision that the counterclaim was not compulsory and ignored the requirement that permissive counterclaims must have a separate basis for federal jurisdiction.

Finally, it was incorrect to hold that Kayne was liable for conversion in any event. The Corporation, not Kayne, continued to hold the warrants which Gross was claiming and no change was made in the entry in the Partnership's books crediting the warrants to Gross (A 2972, 2974). The point that Kayne was making in the letter on which the District Court relied in finding against him was that the Partnership had suffered further losses since the proposed distribution to the

partners and hence a balance would have to be struck before the distribution was actually made. This would apply to Gross as well as then current partners because under the partnership agreement, his capital was left at the risk of the business after his withdrawal.

POINT IV

BLEICH AND DONOGHUE HAVE NO CLAIM AGAINST KAYNE

Even assuming that Bleich and Donoghue were entitled to the return of their capital at the time of the transfer, their claim is against the Corporation as the successor to the Partnership. They have no claim against Kayne. Any claim belonging to Bleich and Donoghue would have to rest upon a violation of §98 in the transfer to the Corporation. But there is no showing that Kayne was aware of any such violation or even that such a violation was possible. He was not at the closing of February 11, 1971, during the time the question was discussed (A 3522). There is no evidence that he had been forewarned that the Rosenman firm would not give an opinion as to the legality of the transfer. In any event, he was entitled to rely upon Persky's legal opinion that the transfer was proper, as did the others present at the closing, all of whom agreed to the transfer (A 1127). There is hence no basis for finding Kayne personally liable for the return of Bleich and Donoghue's capital.

Moreover, Donoghue's claim suffers from a fatal jurisdictional defect. She was not named as a defendant when the Corporation brought its action (1, 3-4). Thereafter, she simply joined in Gross' answer to assert a counterclaim which alleged no independent basis of federal jurisdiction (11-30, 31-54).

She did not move to intervene and, contrary to Judge Owen's statement (509), no subsequent pleading was served and filed making her a party defendant (A 3230, 3234, 3235, 3243, 3245). The District Court therefore had no jurisdiction over her "counter-claim." See Beach v. KDI Corp., 490 F.2d 1312 (3d Cir. 1974); Hartley Pen Co. v. Lindy Pen Co., 16 F.R.D. 141 (S.D. Cal. 1954).

In light of the repeated disregard of not only procedural but jurisdictional precepts in the litigation of this case, it is appropriate to quote the language of this Court in its recent decision in Lank v. New York Stock Exchange, Docket No. 76-7243 (January 20, 1977):

"We note that in the hurly-burly and rush of litigants to make their way into the already overcrowded courts it is not surprising that not only the niceties but also the very fundamentals of rules of practice and procedure are pushed aside. Indeed, there are many who consider these rules to be 'technicalities' to be disregarded whenever possible in the interest of speedy and inexpensive justice. We protest against this trend and would remind those who choose to listen that without rules of procedure all litigation degenerates into chaos. Rules of procedure are intended: to give orderliness and stability to court proceedings; to achieve certainty and to prevent confused reasoning, that great enemy of justice everywhere."

This statement applies with equal force here.

CONCLUSION

The judgment against Kayne should be reversed in all respects and the claims against him dismissed.

Dated: New York, New York
February 4, 1977

Respectfully submitted,
GOLD, FARRELL & MARKS

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STATE OF NEW YORK)
COUNTY OF NEW YORK) ss.:

ROBERT LA GRASSA, being duly sworn,
deposes and says that deponent is not a party to the action,
is over 18 years of age and resides at 62-20 60th Rd.
MASPETH, NYC.

That on the 4th day of FEBRUARY, 19 77,
deponent personally served the within BRIEF OF ADDITIONAL
DEFENDANT ON COUNTERCLAIMS-APPELLANT-CROSS-APPELLEE FRED KAYNE
upon the attorneys designated below who represent the
indicated parties in this action and at the addresses below
stated which are those that have been designated by said
attorneys for that purpose.

~~By leaving true copies of same with a duly
authorized person at their designated office.~~

By depositing 2 true copies of same enclosed
in a postpaid properly addressed wrapper, in the post office
or official depository under the exclusive care and custody
of the United States post office department within the State
of New York.

Names of attorneys served, together with the names
of the clients represented and the attorneys' designated
addresses.

(PLEASE SEE ATTACHED LIST)

Sworn to before me this

4th day of FEBRUARY, 19 77.

Robert La Grassa
Michael DeBarto

MICHAEL DEBARTIS
Notary Public, State of New York
No. 03-0930908
Qualified in Bronx County
Commission Expires March 30, 1978

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